UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Proposed Pricing Policy for	)	
Efficient Operation and Expansion of the	)	Docket No. PL03-1-000
Transmission Grid	)	

COMMENTS OF THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION
JOINED BY

THE UTAH PUBLIC SERVICE COMMISSION;

THE UTAH DIVISION OF PUBLIC UTILITIES;

CHRISTINE O. GREGOIRE, ATTORNEY GENERAL OF WASHINGTON STATE;

KEN SALAZAR, ATTORNEY GENERAL OF COLORADO FOR THE COLORADO OFFICE OF CONSUMER COUNSEL;

PATRICK C. LYNCH, ATTORNEY GENERAL OF RHODE ISLAND;

SEATTLE CITY LIGHT;

THE PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON;

UTAH COMMITTEE OF CONSUMER SERVICES; AND

NATIONAL CONSUMER LAW CENTER ON BEHALF OF ITS LOW-INCOME CLIENTS

Recommending That The Policy Statement Be Tailored To Regional Circumstances And Limited To Actions That Yield Consumer Benefits In Excess Of Consumer Costs

I. INTRODUCTION

1 The Washington Utilities and Transportation Commission and the above named parties (collectively "WUTC et al.") file these comments on the Federal Energy Regulatory Commission's ("Commission") Proposed Policy Statement ("Policy Statement") in Docket No. PL03-1-000. *Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid. 68 Fed. Reg. 3842 (2003).*[1]

2 In its Policy Statement, the Commission proposes to adopt a new policy to: 1) reward transmission owners for joining Regional Transmission Organizations ("RTOs") and turning their assets over for RTO operation; 2) reward transmission owners for forming Independent Transmission Companies ("ITCs"); and 3) reward transmission owners for pursuing additional measures to operate and expand the transmission grid efficiently. *Id. at* ¶ *1.* The Commission proposes to offer these rewards "only [to] transmission owners which participate in RTOs" in order to "promote competitive

[1] Communication information for each party joining in these comments is included as Attachment A.

wholesale electric markets, reduce wholesale electric costs and improve electric reliability." *Id.*

II. SUMMARY

3 We do not question the Commission's authority to use appropriately targeted and effective regulatory tools to encourage actions on the part of public utilities that will benefit electricity consumers. The proposed Policy Statement, however, is a blunt instrument that promises to be neither effective nor beneficial to electricity consumers. On the contrary, the proposed Policy Statement would cause consumers to pay more in rate-of-return incentives than they are likely to receive in benefits. If the Commission adopts any policy to provide bonus rates-of-return as a reward for utility actions, it should:

1) Limit the policy to actions for which reasonably expected consumer benefits outweigh reasonably expected consumer costs (including the utility reward);

2) Tailor the policy to the specific circumstances and needs of regional electricity systems; and

3) Target any rewards to actual and cost-effective new transmission system investment through performance-based rate incentives.

III. JOINT COMMENTS

4 The proposed Policy Statement would provide uniform and significant financial incentives to all public utilities to take the same actions (turn over transmission assets to an RTO or independent transmission company) in all regions of the country, regardless of whether those actions are appropriate, necessary, or beneficial to consumers. The promised "reward" is not targeted to those circumstances where the utility actions to be rewarded are demonstrated to produce significant net benefits to ratepayers. In fact, the Commission states explicitly that it will not require any evidence that incremental benefits resulting from the incentive will exceed costs in order for the bonus rate-of-return to apply. *Id.* ¶ *36.* Indeed, the bonus return is granted to utilities that have *already* taken the actions the Commission wants to induce, as well as to those who have not. Where utilities have already taken the action desired by the Commission, the "incentive" rate of return is nothing more than a means to confer windfall profits at ratepayer expense. Finally, the reward cannot be claimed by the Commission to be targeted to overcome any real or perceived increase in the cost of capital to accomplish system expansion, because the proposed increased rate-of-return applies to both new and *existing* transmission assets—existing transmission assets that

have already been financed, built, and included in rates that (presumably) already provide a just and reasonable rate-of-return.

5 This result cannot be squared with the Commission's mandate under the Federal Power Act to protect electric consumers from unjust and unreasonable rates. On the contrary, for example, the United States Court of Appeals has made clear that "the Commission must – in order to comply with the Federal Power Act and the Administrative Procedure Act – adequately address . . . specific cost-benefit evidence . . . prior to the Commission's final decision on the RTO proposal for the Pacific Northwest." *Public Utility District No. 1 of Snohomish County v. FERC*, 272 F.3d 607, 619 (D.C. Cir. 2001) (citations omitted). The same principle clearly applies to the incentive rate structure proposed here, which is intended in part to jump-start the Commission's effort to force adoption of RTOs uniformly across the nation. *See Tejas Power Corp. v. FERC*, 908 F.2d 998, 1003-04 (D.C. Cir. 1990) (the Commission must "determine whether any benefits or harm might accrue" to consumers).

6 We are responsible, as state utility regulators, elected representatives of the ratepayers of consumer-owned utilities, and consumer advocates, to ensure

7 that retail electricity customers pay rates that are just and reasonable—rates that recover the full cost but *only* the full cost of utility service, including a fair return on investment. We have consistently objected to the Commission's proposed Standard Market Design rulemaking in Docket RM01-12-000, which is clearly related to this new docket, because it fails to recognize important differences among regional electricity systems and because it would impose new and *unnecessary costs* on electricity customers. Similarly, the proposed Policy Statement is a homogeneous policy that is blind to the differences in character and needs among regional electricity grids, and blind to whether the incremental benefits to consumers will clearly outweigh the inducement they are asked to pay. The proposed Policy Statement, therefore, suffers from many of the same flaws as the proposed Standard Market Design rule itself, which it is designed to help achieve.

8 Specifically, the proposed rate-of-return reward is a flawed policy that will be ineffective and injurious both to consumers and to the Commission's objectives, for at least four reasons.

9

1) The policy uses consumer dollars to reward utility actions regardless of whether those actions are demonstrated to be necessary and in the public interest, or to yield net consumer benefits that clearly outweigh the costs of the reward.

10 The Commission proposes to reward utilities for joining RTOs or for divesting transmission assets to independent transmission companies, regardless of regional circumstances or any evidence that consumers will see net benefits from these actions. The reward for these two actions together is proposed to be a 200-basis-point increment to the allowed after-tax return-on-equity for net (undepreciated) transmission investment.

11 The Commission points generally to the recent United States Department of Energy National Grid Study for evidence that consumers will benefit if RTOs and independent transmission companies are formed.[2] In its press release announcing the proposed Policy Statement, the Commission stated that "DOE estimates that millions more could be saved annually by relieving transmission congestion."[3]

---

[2] *National Grid Study*. United States Department of Energy, May 2002, ("Grid Study").

[3] *Commission Proposes Incentive Pricing Policy, Helping to Set the Stage for a Modern Power System*. Federal Energy Regulatory Commission. Press Release. January 15, 2003.

12 The Grid Study estimates that relief of both transmission congestion and pancaked transmission rates could yield nation-wide gross savings of $1.2 to $1.5 Billion annually.[4] However, this estimate does not include the cost of setting up and operating the new grid management institutions such as RTOs. Moreover, the Grid Study assumes that the power markets established by these new institutions will operate with perfect efficiency and suffer no abuse of market power. If power markets fail to be perfectly efficient or suffer market power abuses, as has frequently been the case in restructured electricity systems in this country and in other countries around the world, consumers could well experience incremental costs that far exceed the Grid Study's estimate of gross benefits.

13 To understand the net benefits that consumers *might* obtain from these new institutions, the initial cost for set-up, and the annual cost to operate, the new transmission institutions and power markets must be estimated and removed from the Grid Study's calculation of gross benefits. Projections of set-up and operating costs are necessarily rough estimates, but several sources are

[4] *Grid Study. Table 2. page 85.* High end of range based on load-pocket congestion sensitivity described on page 85.

available.[5] These sources provide data to estimate annual costs, including amortization of start-up costs, in the range of $0.40 to $0.58 per MWH of transmission volume. Based on this range and on 2002 national annual electricity sales of about 3,500 TWH[6], the annual cost to operate these new institutions and markets falls in the range of $1.4 billion to $2.0 billion.

14 Adjusting the Grid Study annual *gross*-savings estimate by $1.4 to $2.0 billion to reflect this range of estimated annual costs, yields an estimate of annual net benefits that ranges from $100 million to a *negative* $800 million--that is, the annual cost of nation-wide implementation of the new markets assumed in the Grid Study may, by itself, equal or exceed the benefits the Grid Study attributes to those markets. For consumers, even this bleak projection may be overly optimistic, because the Grid Study estimate of gross benefits is doubtful; it is simplistic and based on very optimistic assumptions about

---

[5] *See, The Benefits and Costs of Regional Transmission Organizations and Standard Market Design in the Southeast*. Charles River Associates, November 6, 2002. Table 1, page 24. *RTO West Benefit Cost Study*. *Final Report Presented to RTO West Filing Utilities.* Tabors Caramanis and Associates. March 11, 2002. Table 23, page 38. *Economic Assessment of RTO Policy*. ICF Consulting (2002) at page 78. This last study provides only estimates of start-up costs and ignores any incremental operating costs for new institutions. ICF estimates startup costs alone to be $100 to 575 million per year if recovered straight-line over 10 years.

[6] *Electric Power Monthly*. October 2002. United States Department of Energy. Energy Information Administration. Table 2. U.S. Electric Power Industry summary Statistics. Projected through December 2002.

market performance. The assumption that markets will always operate efficiently and with no risk of market power abuse is particularly unrealistic. Nonetheless, it is still interesting to compare the Grid Study savings estimate, adjusted for annual RTO costs, against the approximate magnitude of the ratepayer inducement the Commission is offering to utilities to join RTOs.

15 The aggregate net book value of transmission owned by Commission-jurisdictional utilities nation-wide is at least $40 Billion.[7] An incremental, after-tax, 200-basis-point, return-on-equity for this asset-base would yield about $516 million per year in increased transmission costs to consumers.[8] ***Thus, by its proposed new policy the Commission is making a firm offer to utilities of $516 million of consumers' money in return for a very uncertain, and we believe unlikely, benefit that is only $100 million, a net loss to the Nation's consumers of $416 million.*** This is *not* a fair bargain for consumers. The Commission is proposing to hand over to utilities an inducement from consumers' pockets that in all likelihood exceeds the net benefits consumers

---

[7] *Financial Statistics of Major U.S. Investor-Owned Electric Utilities. 1996.* United States Department of Energy. Energy Information Administration. December, 1997. Table 28. Total transmission plant of $65.5 billion adjusted for average depreciation of 58.6 percent based on ratio of net total utility plant to total utility plant. This is the most current data published by USDOE EIA. Since 1996 additional investment has undoubtedly been added with little depreciation.

might see from new RTO-operated markets, even under optimistic assumptions.

16 Examination of the Commission's proposed rewards in the context of savings and cost figures for the proposed RTO West provides another example. Estimates of net "savings" from RTO West vary from a negative $(107 million) per year to $162 million.[9] The higher number is based on optimistic assumptions about market performance. The lower number (a net cost) is based on a critique of the study done to correct alleged modeling errors.[10] The mid-point in this range is $27.5 million per year.

---

[8] Assumes that equity is 40 percent of capital structure and the average tax rate on equity return is 38 percent. [2.0 percent * .40/.62 = 1.29 percent * 40 billion = 516 million].

[9] *RTO West Benefit/Cost Study. Tabors Caramanis & Associates. March 11, 2002* ("Tabors Study") Gross estimates of $36 to $305 Million of estimated savings adjusted for estimated annual cost of $143 Million. ($0.51/MWH across 280 TWH of volume).

[10] *Corrections to the Benefits/Costs Study for RTO West. April 19, 2002.* Linc Wolverton, Industrial Customers of Northwest Utilities. In a more refined analysis, Pacific Northwest consumer-owned utilities estimated that the net *loss* to consumers in the region from RTO West could amount to as much as $445 million per year. *See Protest of the Public Generating Pool, the Washington Public Utility Districts Association, the Western Public Agencies Group, Public Utility District No. 1 of Snohomish County, Springfield Utility Board, Tacoma Power, and the Eugene Water and Electric Board on the Filing Utilities' Stage 2 Filing and Request for Declaratory Order Pursuant to Order 2000, FERC Docket No. RT01-35-005 (May 28, 2002).*

17 The net transmission plant owned by Commission-jurisdictional utilities in the Northwest Power Pool is approximately $2.5 Billion.[11] The 200-basis-point inducement the Commission proposes would yield approximately $32 million per year to transmission owners. The math is simple—consumers suffer a net cost because the annual $32 million inducement exceeds reasonably estimated benefits of only $27.5 million.[12] Again, the Commission is proposing to hand over a reward to utilities from the consumers' pocket that exceeds any benefit the consumer is likely to see.

18 If the Commission adopts any policy providing for incentive rates-of-return, it should be one that costs consumers demonstrably less than the reasonably estimated benefits. Otherwise, the Commission will have given all (or more than all) of the benefits to the utilities and left the consumer with much of the risk of restructuring, new grid institutions, and new energy markets.

---

[11] Based on current FERC Form 1 for Avista Corp., Puget Sound Energy, PacifiCorp, Idaho Power, Portland General Electric, and Sierra Pacific.

[12] This regional analysis confirms and supports the earlier-stated national analysis because in the Pacific Northwest the inducement applies to only 20 percent of the transmission assets that might be transferred to an RTO. The Commission does not set the rates for the remainder of the transmission. In most of the nation the ratio of transmission that is jurisdictional to the Commission to total transmission in a region is far higher than 20 percent.

2) The proposed Policy Statement does not reduce and may actually increase investment uncertainty.

19 The Commission cannot ensure delivery of its proposed incentives because Washington State utilities, and utilities in many other states across the country, cannot join an RTO or divest their transmission assets to an independent transmission company without approval of the state utility regulator.[13] A reasonable expectation of consumer benefits will be a key factor that state utility regulators will consider in determining whether to approve utility requests to join RTOs or otherwise dispose or assign transmission assets. Taking the Pacific Northwest as an example, benefit-cost analyses for RTO West demonstrate only modest, if any, benefits, even before consideration of a new rate-of-return reward. Increasing the costs of RTO West by immediately increasing the cost with bonus rates-of-return only increases the likelihood that estimated costs to consumers will outweigh estimated benefits. The Commission's proposed Policy Statement may

[13] In Washington State for example: "No public service company shall sell, lease, assign or otherwise dispose of the whole or any part of its franchises, properties, or facilities whatsoever, which are necessary or useful in the performance of its duties to the public, and no public service company shall, by any means whatsoever, directly or indirectly, merge or consolidate any of its franchises, properties or facilities with any other public service company, without having secured from the commission an order authorizing it to do so." *RCW 80.12.020.*

introduce an expectation among transmission investors that the policy itself may undermine.

3) The proposed Policy Statement fails to encourage investment in new transmission infrastructure because it is primarily targeted to induce RTO formation, not to overcome actual capital cost barriers or induce investment in new and needed infrastructure.

20 Under the proposed Policy Statement, most of the rewards are offered for structural and institutional change, not for new investment in infrastructure.[14] The magnitude of any new transmission investment over the foreseeable future will pale in comparison to the total existing investment in transmission plant. Yet, the Commission is asking consumers to pay utilities more than the reasonable and sufficient rate-of-return for capital most of which the utilities have already obtained and have already invested in *existing* transmission facilities. If the Commission is truly interested in encouraging investment in *new* incremental transmission infrastructure, it should target its largess with consumers' money to economically efficient new investment—investment that solves actual transmission system needs, instead of simply providing a

[14] A transmission owner might earn as much as an extra 300 basis points, but only the last 100 basis points are associated with new investment. The first 200 basis points are earned by simply joining an RTO or divesting existing transmission assets to an independent transmission company.

naked inducement to further a restructuring agenda primarily for existing plant and equipment. For example, a well-structured performance-based rate plan that shares the risks and benefits of new transmission investment between investors and consumers in an appropriate way could address this issue effectively, and with more fairness than the blunt approach proposed in the Policy Statement.

4) The proposed Policy Statement fails to recognize that much of the transmission considered for RTO formation is owned by non-Commission-jurisdictional utilities.

21 Taking the Pacific Northwest as an example, the effect of the Commission's proposed rewards would be to increase the rates paid only by consumers served by the roughly 20 percent of regional transmission assets that are owned by investor-owned utilities. Yet, investor-owned transmission rates are already higher than the transmission rates of the Bonneville Power Administration and other public power utilities. The issue of cost-shifts among the public and private utility transmission systems has continually been a controversial issue in RTO and other regional transmission discussions. The Commission's proposed policy would serve only to enlarge the disparity between public and private utility transmission rates in the Northwest and make it less likely, not more likely, that the region could eliminate rate pancaking—one of the Commission's goals for its incentive pricing policy.

IV. CONCLUSION

22 The Commission should reject the proposed uniform policy of transmission investment rate-of-return rewards as too blunt, unfair, ineffective, and counterproductive. If the Commission adopts any policy to encourage investment in new transmission infrastructure, that policy should be designed to fit specific regional circumstances, and to apply only if the actions to be rewarded yield benefits to consumers that substantially outweigh the inducement those consumers are expected to pay to utilities. A well-targeted performance-based incentive for cost-effective investments in new transmission infrastructure would be more effective and more fair to consumers and investors than the blanket incentives offered in the proposed Policy Statement.

DATED at Olympia, Washington, this __ day of March 2003.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

____________/s/____________
MARILYN SHOWALTER, Chairwoman
____________/s/____________
RICHARD HEMSTAD, Commissioner
____________/s/____________
PATRICK J. OSHIE, Commissioner

THE UTAH PUBLIC SERVICE COMMISSION

____________/s/____________
STEPHEN F. MECHAM, Chairman
____________/s/____________
CONSTANCE B. WHITE, Commissioner
____________/s/____________
RICHARD M. CAMPBELL, Commissioner

THE UTAH DIVISION OF PUBLIC UTILITIES

____________/s/____________
Lowell E. Alt, Director

ATTORNEY GENERAL OF WASHINGTON

_______/s/_________
Simon J. ffitch, Assistant Attorney General

COLORADO OFFICE OF CONSUMER COUNSEL

By their Attorney
________/s/________
Stephen H. Southwick

ATTORNEY GENERAL OF RHODE ISLAND

_______/s/_________
Paul Roberti, Assistant Attorney General

SEATTLE CITY ATTORNEY'S OFFICE

Director, Utilities Section

_______/s/_________
William H. Patton

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WA

By their Attorney

_______/s/_________
Michael J. Gianunzio

UTAH COMMITTEE OF CONSUMER SERVICES

________/s/________
Roger Ball, Director

NATIONAL CONSUMER LAW CENTER

By their Attorney
________/s/________
Charles Harak, Esq.

Attachment A
COMMUNICATIONS

The name and address for Washington Utilities and Transportation Commission:

Robert D. Cedarbaum
Senior Counsel
Office of the Attorney General
1400 S Evergreen Park Drive SW
P.O. Box 40128
Olympia, WA 98504-0128

Name and address for Utah Public Service Commission and Utah Division of Public Utilities

Sander Mooy
Legal Counsel
Utah Public Service Commission
160 East 300 South
Salt Lake City, UT 84111

George Compton
Technical Consultant
Utah Division of Public Utilities
160 East 300 South
Salt Lake City, UT 84111

Name and address for Colorado Office of Consumer Counsel:

Stephen H. Southwick
Assistant Attorney General
Consumer Protection Section – OCC Unit
1525 Sherman Street, 5th Floor
Denver, CO 80203

Name and address for Washington State Attorney General

Simon J. ffitch
Assistant Attorney General
Washington Attorney General
900 Fourth Avenue, Suite 2000
Seattle, WA 98164

Name and address for Rhode Island Attorney General

Paul Roberti
Assistant Attorney General

Chief, Regulatory Unit
Department of Attorney General
150 South Main Street
Providence, RI 020903

Name and address for Seattle City Light

William H. Patton
Director, Utilities Section
10th Floor Municipal Building
600 Fourth Avenue
Seattle, WA 98104-1877

Name and address for Public Utility District No. 1 of Snohomish County, WA:

Michael J. Gianunzio
General Counsel
Eric Lee Christensen
Associate General Counsel
Public Utility District No. 1 of Snohomish County, Washington
PO Box 1107
2320 California Street
Everett, WA 98206-1107

Name and address for Utah Committee of Consumer Services:

Roger Ball
Director
Utah Committee of Consumer Services
PO Box 146782
Salt Lake City, Utah 84114-6782

Name and address for National Consumer Law Center:

Charles Harak, Esq.
National Consumer Law Center
77 Summer Street, 10th Floor
Boston, MA 02110-1006